



Jason P. Blose  
Attorney

December 13, 2012

Re: Chesapeake Lease No.  
Troy Township, Bradford County, Pennsylvania

Dear

On behalf of Chesapeake Appalachia, L.L.C. ("Chesapeake"), I have been asked to respond to your letter dated November 6, 2012 in which you assert that Chesapeake is improperly paying royalty pursuant to the above referenced oil and gas lease ("Lease"). For the following reasons, it is Chesapeake's position that your royalties have been properly calculated.

As stated in your letter, the Lease states that lessee agrees "to pay Lessor, free of cost, a royalty of one-eighth (1/8<sup>th</sup>) of the revenue realized by Lessee for all gas marketed from the Leasehold." Your letter states your position that "by deducting gathering and third party costs, Chesapeake has applied their production costs to us."

By way of background, gas produced from the Lease is in marketable form at the wellhead, and is sold by Chesapeake to Chesapeake Energy Marketing, Inc. ("CEMI") at this point. CEMI is a marketing company which takes title to and possession of gas at the wellhead, and sells that gas at downstream value-added points of sale, typically on an interstate pipeline. CEMI pays Chesapeake 97 percent of the sales price CEMI receives (CEMI retains a 3 percent marketing fee which is borne solely by Chesapeake and is not passed on to you), less the costs CEMI incurs between the wellhead point of sale and the value-added downstream points of sale. The costs incurred by CEMI include a compression fee, gathering fee, and a transportation fee, as indicated in your royalty statements.

As mentioned above, the Lease requires royalties be paid based on the revenue realized by lessee. The revenue realized by Chesapeake is that received in the wellhead sale from Chesapeake to CEMI. Your claim that Chesapeake has applied the

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costs of production to you is simply incorrect. Your royalty is free of the cost of production. In Kilmer v. Elexco Land Services, Inc., 990 A.2d 1147 (Pa. 2010), the Pennsylvania Supreme Court recently recognized that a lessor's royalty is generally free of the cost of production, but is subject to a proportionate share of post production costs. Id., at 1152, 1157.

I hope this letter adequately addresses your concerns. Should you need further information, please do not hesitate to contact me.

Very truly yours,



Jason P. Blose